



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **201340020**
Release Date: 10/4/2013

Date: July 10, 2013

UIL: 501.00-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Karen Schiller
Acting Director, EO Rulings and
Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224**

Date: April 16, 2013

501.00-00

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

B =

M =

x =

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code (I.R.C.) § 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under § 501(c)(3). The basis for our conclusion is set forth below.

Facts:

You are a not-for-profit corporation seeking recognition of exemption under § 501(c)(3) and classification as a public charity under § 509(a)(2).

According to your initial Articles of Organization ("initial Articles"), your specific objectives and purposes are "charitable and educational." Your initial Articles further state that your aims are to "strengthen communities that are ill-served by existing media, specifically by broadening the informed electorate by publishing original journalism that provides civic education for the less-than-affluent public, and publishing the journalism on the internet through software that builds community cohesion by enabling and encouraging civic networking."

Your Form 1023 Narrative states that you seek to deliver reporting and journalism to particular sectors of various communities that you identify as poorly served by current news reporting. You state that B, your President and Director, has compiled research from various sources that indicate current news reporting does not meet the information needs of the middle-income sector. Your purpose is the education of these underserved communities through original reporting and carefully repurposed content published online, and made available to the public free of charge.

In your letter dated December 5, 20 ("modification letter"), you state that you have modified your planned activities. You modified your Bylaws and Initial Articles accordingly. You state you will further your educational and charitable purposes through the development, licensure and distribution of publishing software to news organizations you select ("the licensees") for a fee. You have not prepared your licensing agreement yet. You also plan to provide back-office support to the licensees "at cost" but this activity is secondary to your primary activity of development and licensure of your software. You will require the licensees to publish their online newspaper free of charge to the public.

You state your software is designed to enable and invite public collaboration in the editorial process, to increase civic engagement and to help readers organize for community change, in addition to publishing journalism online. In your modification letter, you state that you will provide licensees with licensed use of your publishing software for a fee, as well as automated support services. Your project proposal states that some selected components of your software will be licensed for open-source development and placed in publicly accessible repositories. A small portion of the remaining components of the software may be modified or customized by your licensees. The remaining components of your software may not be modified except by you. You state only the logo and colors will be customizable.

The back-office services will be part of the actual software, and performed by automation rather than by your staff. You may provide limited and occasional services to the licensees for a fee. This will include training on the software. It may be provided by you or by third parties. B will provide consulting services to the licensees for a fee. You did not explain the nature of the consulting services or provide a representative copy of your contract with B for consulting services. You state that you may provide some training to the licensees on the use of your software and may provide some limited, informal guidance on the formation of a cooperative association.

You state you will not publish any news. Instead, your staff will periodically prepare certain "life-issue" articles, which you will offer to your licensees for publishing on their respective online newspapers. You state that these articles be related to such subjects as personal finance, employment, and health. The licensees may modify these articles, and may publish the articles in their discretion. The licensees will be otherwise independent of you and will be responsible for the reporting, content preparation and publishing of their respective online newspapers.

You expect the licensees to have volunteer or paid staff, consisting of at least one reporter and a director. The licensees will be able to provide feedback to you about the development of the software and its functions. You state the software will allow image galleries, video reports, animated charts and graphs, and news category taxonomy. The software will also provide certain business administration functions, such as record keeping, automated membership tracking and marketing. It will also include touch-screen features so the licensees can publish from mobile and tablet devices.

You state you will charge the licensees an initial fee for use of your software, the amount of which has not yet been determined by you. You did not describe the purpose of the initial fee. The licensees must submit a feasibility study and have the funds necessary for a successful launch, as determined by the feasibility study. The licensees must also agree to adhere to your "value proposition" which provides that the journalism published is (i) relevant to the less-than-affluent readership, (ii) respectful of them as people, and (iii) worthy of their trust. The licensees

must also have the funds for paying other initial costs, such as organizational fees and membership in local chamber of commerce. You state you expect to charge the licensees an undetermined annual fee based on a percentage of the licensee's gross revenues, with a minimum of \$x annually. You state you expect to "break-even" after licensing the software to 15 to 18 licensees.

You expect your income from software licensing fees to increase and income from grants to decrease over time, so that ultimately, your revenue will be generated almost exclusively from licensing fees. You state you also expect a limited amount of revenue will be generated from contracting services to the licensees.

Your Form 1023 stated you expected to collect fees from members. The members would consist of the readers and their supporters. Members would have voting rights, and have access to particular benefits, including, but not limited to, organizing community sports leagues, educational lectures, discount programs with local businesses, ability to advertise their own businesses, and a profit distribution. Your Form 1023 stated the members' organization would be similar to a "cooperative society." Your modification letter states that you will not have any members. Your Bylaws were amended to reflect that your organizational structure does not have members. However, your modification letter states that you expect your licensees to be organized as cooperative associations, consisting of paying members who are residents of a given community. You require the licensees to publish content that is relevant to those members. You do not require your licensees' organization to be a particular form. Your Form 1023 stated you do not expect the licensees to be tax-exempt organizations. Your modification letter clarified that your sole relationship to the licensees is primarily a licensor-licensee relationship.

Your website M (copy submitted by you, enclosed), states that as your number of licensees and readers grow, you may participate in a broad array of ancillary activities. You have not described such activities. You state that you may manage such activities on behalf of the licensees and share net revenues from those activities with your licensees.

Law:

I.R.C. § 501(c)(3) exempts from federal income tax corporations organized and operated exclusively for charitable and educational purposes, among others, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that in order to be exempt as an organization described in § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in § 501(c)(3). If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides an organization will not be regarded as a § 501(c)(3) exempt organization if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

Treas. Reg. § 1.501(c)(3)-1(d)(2) states the term "charitable" is used in § 501(c)(3) in its generally accepted legal sense, and that it includes: relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

Treas. Reg. § 1.501(c)(3)-1(d)(3) states the term educational includes the instruction or training of the individual for purposes of improving or developing the individual's capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community.

Rev. Rul. 66-147, 1966-1 C.B. 137, provides preparing, publishing and distributing abstracts of scientific and medical literature by highly trained professionals without charge is an exempt, educational activity.

Rev. Rul. 69-528, 1969-2 C.B. 127, provides an organization that is primarily engaged in carrying on an investment management business for charitable organizations on a fee basis, free from control of the participants, is not exempt.

Rev. Rul. 69-572, 1969-2 C.B. 119, provides an organization that constructed and provided use of real property in order to materially aid the users of its facilities in the performance of their respective charitable functions is an exempt activity.

Rev. Rul. 71-529, 1971-2 C.B. 234, provides an organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualifies for exemption. The organization's board is composed of representatives of the member organizations. The organization was performing an essential function for charitable organizations.

Rev. Rul. 72-369, 1972-2 C.B. 245, provides an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption. It states an organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the "operational test" the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of § 501(c)(3) and the applicable regulations. Providing managerial and consulting services on a regular basis for a fee is trade or business ordinarily carried on for profit. The ruling holds that furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

Rev. Rul. 74-587, 1974-2 C.B. 162, holds that a nonprofit organization that provides financial assistance to businesses otherwise unable to obtain funds from conventional commercial sources due to their location in depressed urban communities or the proprietor's membership in a minority or other disadvantaged group qualified for exemption. The organization activities furthered the exempt purposes of relieving poverty, eliminating prejudice, reducing neighborhood tensions, and combating community deterioration.

Rev. Rul. 76-419, 1976-2 C.B. 146, provides an organization that induced industrial enterprises to locate in an economically depressed area and to hire and train the underemployed and unemployed in that area is exempt. The organization's activities serve not only to relieve poverty, but also to lessen neighborhood tensions caused by the lack of jobs and job opportunities in the area. Further, by creating an industrial park out of a blighted area, the organization is combating community deterioration.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under § 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial businesses.

In Easter House v. U.S., 12 Cl. Ct. 476 (1987), the organization, in exchange for a fee, provided adoption services to parents seeking to adopt a child, including services to pregnant women who intended to place their newborns for adoption. These fees were the organization's sole source of income. The Claims Court concluded that the organization's business purpose of operating an adoption service, not the advancement of educational and charitable activities, was its primary goal. It competed with other commercial organizations providing similar services. Thus, "[p]laintiff's competition provides its activities with a commercial hue." 12 Cl. Ct. at 486. Accordingly, the organization did not qualify for exemption under § 501(c)(3).

Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), involved an organization that operated restaurants and health food stores with the intention of furthering the religious work of the Seventh-Day Adventist Church as a health ministry. However, the Seventh Circuit held that these activities were primarily carried on for the purpose of conducting a commercial business enterprise. Therefore, the organization did not qualify for recognition of exemption under § 501(c)(3).

Rationale:

Section 501(c)(3) exempts from federal income tax corporations organized and operated exclusively for charitable and educational purposes. Additionally, § 1.501(c)(3)-1(d)(3) states the term "educational" includes the instruction or training of the individual for purposes of improving or developing the individual's capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community. Based on the information provided, you are not operated exclusively for one or more purposes as specified in § 501(c)(3) and may be operated for a substantial nonexempt purpose.

Your primary activity is the development, distribution, and licensing of publishing software for a fee. You also plan to provide limited, informal information on the formation of cooperative associations to the licensees of your software. While such activity may be considered educational, you have stated this is not your primary activity. You or persons, with whom you contract, will provide training to licensees on how to use of the software itself. You have not provided information that the software itself is designed to instruct or inform its licensees how to publish a newspaper or how to perform other journalistic activities. Instead, your software provides the basic platform for newspaper publishing so that its users can publish a newspaper without publishing training and experience.

While this activity may be educational to some degree, you have not indicated how much of this training on your software use will be provided by you or by contractors. Instead, the purpose of the training appears limited to the ability and efficient use of a product developed by and licensed to the user for a fee. This is distinguishable from the organization described in Rev. Rul. 66-147, 1966-1 C.B. 137, which published and distributed abstracts of scientific and medical literature prepared by highly trained professionals without charge. The content distributed by that organization was not limited to instruction on the use of products developed by the organization, and it was not distributed for a fee. Rev. Rul. 72-369, supra holds that managerial and consulting services on a regular basis for a fee is trade or business ordinarily carried on for profit because furnishing the services at cost lacks the donative element necessary to establish this activity as charitable. In addition, Rev. Rul. 69-528, supra provides an organization that is primarily engaged in carrying on an investment management business for charitable organizations on a fee basis, free from control of the participants, is not exempt.

The distribution and licensing of the software may be a charitable activity if such activity is limited to a charitable class and if the fee is substantially below the corporation's costs. For example, in Rev. Rul. 71-529, supra, an organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualifies for exemption. However, your licensees are not restricted to a charitable class, such as the poor or underprivileged, or other exempt organizations. In addition, you require the licensees to demonstrate financial feasibility, and have minimum funds to cover their costs as well as pay an initial fee to you. You state that you expect the persons to whom it will distribute and license the software will be cooperative associations, which may or may not be not-for-profit entities. You also do not expect nor do you require the licensees to qualify as exempt organizations. You state that you will have no relationship with the licensees other than as licensor-licensee. You also intend to charge each of your licensees an annual fee equal to an undetermined percentage of the licensee's gross revenues, with a minimum of \$x annually. This fee system does not ensure that the fees charged to licensees are substantially below cost. While you may provide back-office services at cost, the fact that you charge a fee for other services indicates a lack of a donative intent, as provided in Rev. Rul. 72-369, supra. Without more, the development, distribution and licensing of software for a fee is not an exempt activity.

The publication of newspapers may be an educational activity; however, you will not be publishing any news. Instead, your licensees will publish the newspapers. You do not have any control or supervision over the licensees. Your only control over the licensee publishing activity is a check to assure the licensee upholds your "value proposition" that the journalism published is relevant to the less-than-affluent readership, respectful of them as people, and worthy of their trust. Other than this, you do not engage in any other activity to ensure that the content,

distribution and preparation methods of the licensees' publishing activities are educational.

In some circumstances, an organization will qualify for exemption even where it directly benefits a for-profit, or otherwise nonexempt, organization. Unlike the organizations described in Rev. Rul. 74-587, supra and Rev. Rul. 76-419, supra, your licensees are expected to be run primarily by volunteers, which will not lower unemployment rates in a destitute or underemployed community. Your purpose and intention is for these businesses to fill a gap in journalism which otherwise largely ignores the less-than-affluent economic class, currently underserved by commercial newspapers. However, a community being underserved by relational journalism is not comparable to a depressed community plagued by high unemployment, physical deterioration, or poverty. Relational journalism is not basic need comparable to nutrition, safety, shelter, or minimum income, which are the types of needs alleviated by the organizations described in Rev. Rul. 74-587, supra and Rev. Rul. 76-419, supra.

Section 1.501(c)(3)-1(c)(1) provides an organization will not be regarded as a § 501(c)(3) exempt organization if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Carrying on activities not related to an exempt purpose and which are indistinguishable from commercial enterprises does not support exemption under § 501(c)(3). See Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991).

Developing, licensing and distributing software for a fee to licensees which are not exempt organizations is an activity typically carried on commercially. In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under § 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial businesses. Your licensees will pay for the software and its automated back-office support through annual fees. The licensing fees are your primary source of revenue. Your licensees will also pay you for consulting or contracting services. You also state the licensees will pay you for management of ancillary activities, which you did not describe, in exchange for a portion of the revenues generated by those activities. The individuals providing such services are not volunteers. Though you state you expect to recover your costs upon securing a certain number of licensing agreement, licensees will still be charged a minimum annual fee. Your activities compete with other commercial publishing software developers and distributors. Such competition provides your activities with a commercial hue. See Easter House v. U.S., 12 Cl. Ct. 476 (1987). Like the organizations in Rev. Rul. 72-369, supra, and Rev. Rul. 69-528, supra, you have not established that your activities are distinguishable from commercial activity. Based on your limited educational activities, more than an insubstantial part of your activities are not in furtherance of charitable or educational purposes, or other exempt purposes.

Conclusion

Based on the information provided, you do not qualify for exemption as an organization described in § 501(c)(3) because you are not operated exclusively for one or more exempt purposes under § 501(c)(3). You must file federal income tax returns.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service

1111 Constitution Ave, N.W.
Washington, DC 20224-0002

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Holly O. Paz
Director, Rulings and Agreements